

RATING ACTION COMMENTARY

Fitch Rates Johnson County, KS's GO Bonds 'AAA'; Outlook Stable

Fri 17 Jul, 2020 - 10:52 AM ET

Fitch Ratings - New York - 17 Jul 2020: Fitch Ratings has assigned a 'AAA' rating to the following Johnson County, KS obligations:

--\$98.47 million unlimited tax general obligation (ULTGO) internal improvement and refunding bonds, series 2020A;

--\$10.2 million taxable general obligation refunding bonds, series 2020B.

Fitch also affirms the following county ratings:

--Issuer Default Rating (IDR) at 'AAA';

--\$510 million outstanding ULTGO bonds at 'AAA';

--\$30 million Public Building Commission (PCB) lease purchase revenue bonds (general fund pledge), series 2010 A, B, C & D at 'AAA'.

The Rating Outlook is Stable.

The 2020A ULTGO bonds are being issued to fund certain wastewater and other public improvements and to refund outstanding debt on the series 2009B and series 2010D bonds. While there is a ULTGO pledge for bond repayment, the county intends to pay the wastewater portion of the bonds with waste water enterprise revenues. The 2020B taxable UTLGO bonds will refund series 2011A bonds. The bonds will be sold competitively on July 22, 2020.

SECURITY

All ULTGO bonds are obligations of the county to which the full faith, credit and power of the county to levy unlimited ad valorem (AV) taxes are pledged; the ad valorem tax pledge on the ULTGO series 2010B & E bonds excludes the AV of the towns of Olathe and Bonner Springs.

The PBC bonds are special limited obligations payable solely from lease payments made by the county from any legally available funds. The county's obligation is absolute and unconditional and is not subject to appropriation, abatement, setoff or counterclaim.

ANALYTICAL CONCLUSION

The 'AAA' IDR, GO and PBC ratings reflect the county's strong revenue and expenditure frameworks, low long-term liabilities and the highest gap closing ability and financial flexibility to address the current pandemic

related economic downturn. The rating on the PBC bonds rating is on par with the county's other outstanding general obligation debt given that the lease payments are not subject to appropriation.

ECONOMIC RESOURCE BASE

Johnson County is located 12 miles southwest of Kansas City, providing residents with easy access to numerous employment opportunities throughout the metropolitan region. The population of 602,401 in 2019 reflects 10.7% growth since the 2010 Census, making the county the most populous in the state. Income and educational levels are well above state and national averages with almost 55% of the population holding bachelors or advanced degrees. The largest employers are diverse and include Sprint Telecommunications with 6,000 employees, Garmin International with 4,100 and other employers include healthcare, education and other sectors. The unemployment rate is typically below state and national levels, and the county has seen modest job growth since 2013.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Fitch expects the county's revenues to grow at a pace that remains above inflation. The county maintains a high level of independent legal ability to raise revenues even after the implementation of a statewide property tax limit (the tax lid) in 2018.

Expenditure Framework: 'aa'

Expenditures are expected to grow at a rate generally in line with revenue growth. The county has solid expenditure flexibility given management's control over its workforce and low carrying costs for debt service and annual post-employment benefit contributions.

Long-Term Liability Burden: 'aaa'

Johnson County's long-term liability burden, including pension liabilities and overall debt, is low relative to personal income.

Operating Performance: 'aaa'

The county has the highest gap-closing capacity to manage through the current pandemic related economic downturn and maintain healthy reserve levels. The county's five-year budget assumes that the county will align spending to minimize the use of general fund reserves over the medium term.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not applicable for 'AAA' ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

---Economic contraction extending well into fiscal 2021 or beyond, consistent with Fitch's coronavirus downside scenario, which triggers

sustained and deep revenue declines and materially erodes the county's gap-closing capacity;

--The inability to maintain long-term financial flexibility sufficient to address periods of economic weakness.

--Shifts in the county's revenue framework including slower revenue growth prospects.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [\[https://www.fitchratings.com/site/re/10111579\]](https://www.fitchratings.com/site/re/10111579).

CURRENT DEVELOPMENTS

Sector-Wide Coronavirus Implications

The coronavirus outbreak creates an uncertain global environment for U.S. state and local governments and related entities in the near term. Fitch's ratings are forward looking, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates

to severity and duration. The agency will incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in the first half of 2020 at a speed and depth that is unprecedented since World War II. Recovery begins from the third quarter of 2020 onward as the health crisis subsides after a short but severe global recession. GDP remains below its fourth quarter 2019 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the April 2020 reports "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers" on www.fitchratings.com.

Budget Impacts of the Pandemic

The governor of the state of Kansas issued an executive order that instituted a state-wide stay-at-home order in response to the pandemic, with a phased in reopening framework that began on May 4, 2020. In response, county management took action in March to address potential revenue shortfalls including implementing a hiring freeze, furloughing some employees, reducing discretionary spending and delaying some capital projects. On June 25, the county received \$117 million in CARES Act funding to offset any expenditures incurred as a result of the pandemic. Based on year-to-date revenue collections, the county believes that the overall impact to revenues will be more modest than the negative 10% projection that was incorporated into the adjusted budget. Currently, the county is estimating between a \$12 million to \$15 million general fund revenue shortfall, offset with \$25 million in expenditure reductions. The county anticipates a modest use of general fund reserves for one-time capital and other non-recurring expenditures in the fiscal year ending Dec. 31, 2020. The savings were attained through employee vacancy and furlough savings, reductions in employee overtime and contractual services and through some reductions or deferrals in capital projects.

The fiscal 2021 proposed budget assumes that sales and use tax will decrease by 4% from the fiscal 2020 adopted budget, strategically eliminates vacant positions for expenditure savings and appropriates \$7.2 million in general fund balance. Fitch believes that the revenue assumptions may be somewhat optimistic given the high level of economic uncertainty associated with the pandemic. The county has outlined contingency plans to address potential revenue shortfalls including approximately \$6 million in additional expenditure reductions. The county's five-year forecast includes modest revenue growth assumptions and limited use of general fund reserves to balance operations. Management has identified multiple expenditure contingencies and capital project deferrals to address potential revenue shortfalls should there be delays in an economic recovery.

CREDIT PROFILE

The county's diverse local economy is characterized by a well-educated population with high wealth and low unemployment. Johnson County has the highest median household income and per-capita personal income in the state. The local economy benefits from extensive employment opportunities throughout the Kansas City metropolitan statistical area (MSA). An improving housing market and strong ongoing development has contributed to solid AV growth in recent years. The county reports significant ongoing development including several multi-use developments and commercial construction projects throughout the county. Job growth and personal income has been positive since 2011, and unemployment is below state and U.S. rates.

REVENUE FRAMEWORK

The county is largely reliant on property and sales tax receipts, which comprised 74% of fiscal 2019 general fund revenue. Charges for services

(15%), intergovernmental revenue (6.6%) and other revenue sources made up the remainder.

Fitch believes the county's general fund revenue growth prospects will exceed the rate of inflation due to healthy growth in assessed values, population and personal income over the past 10 years. The county anticipates that AV growth will continue to exceed the rate of inflation, although at a slightly lower margin than in the past. The projected average annual growth in AV for fiscal years 2020 through 2025 is expected to be 4.9%, which is lower than the expansion from fiscal 2015 through 2018 when growth exceeded 6% annually.

The county retains significant revenue-raising ability even after the implementation of a statewide tax lid in 2019, which limits the ability of cities and counties to increase property taxes beyond CPI growth without voter approval. Most public safety and debt service expenditures are exempt from the law, which allows the county to adjust revenues for these key components of the general fund budget. The county also maintains some ability to adjust other locally controlled revenues and can issue bonds to pay for several capital-eligible general fund expenditures without a referendum, in effect making these expenditures exempt from the tax lid.

EXPENDITURE FRAMEWORK

The county's main expenditure item is public safety, at 51% of fiscal 2019 general fund expenditures. Approximately 32% of expenditures are for general government, 7% for social services and an additional 8% are for capital outlay.

The natural pace of spending growth will likely be in line with to marginally above the revenue growth prospects over time. The main driver of expenditure growth is labor and salaries, which have typically grown by approximately 3% annually; however, the county may budget smaller annual increases in the near term to address potential revenue shortfalls.

The county has solid flexibility within its main expenditure items, and carrying costs for debt and retiree benefit contributions made up a modest 6% of governmental expenditures in 2019. The county had maintained a notable degree of control over labor-related expenditures after having restored a number of positions cut during the last recession. The county routinely funds capital expenditures through the general fund which will be reduced in the near term to address pandemic related revenue shortfalls. Management is managing the current revenue shortfall through employee attrition and hiring freezes but has identified numerous possible expenditures cuts that include furloughs and layoffs in the event of a prolonged economic downturn.

LONG-TERM LIABILITY BURDEN

The county's long-term liabilities are low, with the combined net pension liability and overall debt at approximately 6.2% of personal income. Direct debt accounts for less than 1% of the long-term liability burden once adjusted for self-supporting enterprise debt and overlapping debt accounted for 86%, largely from various cities and school districts within the county. The county has modest tax-supported direct debt, as it has historically funded general capital improvement needs on a pay-go basis.

The county's capital improvement plan includes approximately \$75 million in wastewater general obligation bonds, payable with enterprise revenues; approximately \$23 million in debt issued through the PBC for various

capital projects and \$6.5 million in general obligation debt for land acquisition near the airport for future development.

The long-term liability metric includes the county's participation in the multi-employer Kansas Public Employees Retirement System (KPERS) and the Kansas Police and Firemen's Retirement System (KP&F), which account for almost 14% of the overall burden. The pensions have a combined Fitch adjusted ratio of assets to liabilities or 55.6%, reflecting a 6% investment rate of return on assets.

OPERATING PERFORMANCE

The county has the highest gap closing ability to manage through the current economic downturn given the healthy general fund balance of \$99.3 million, or 31% of general fund spending, that result from four consecutive operating surpluses. Fitch expects that the county's superior inherent flexibility coupled with its high available general fund reserves will provide a very strong level of cushion to address pandemic related financial pressures including revenue shortfalls.

The county increased reserves during the post-recession economic recovery, despite periodically spending down some of its sizable available fund balance on pay-go capital projects prior to 2016 and keeping the tax levy rate relatively constant. The county conservatively forecasts its revenue sources, and while it appropriates general fund balance, management has a strong history of out-performing budget projections. Fitch believes the county will continue to maintain very strong financial performance based on the county's five-year financial plan that incorporates expenditure controls and maintains general fund balance of approximately 25% of spending.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Johnson County (KS) [General Government]	LT IDR	AAA Rating Outlook Stable	Affirmed
● Johnson County (KS) /General Fund Pledge/1 LT	LT	AAA Rating Outlook Stable	Affirmed
Johnson County (KS)	LT	AAA Rating Outlook Stable	Affirmed

FITCH RATINGS ANALYSTS

Shannon McCue

Director

Primary Rating Analyst

+1 212 908 0593

Fitch Ratings, Inc. Hearst Tower 300 W. 57th Street New York 10019

Matthew Wong

Director

Secondary Rating Analyst

+1 212 908 0548

Marcy Block

Senior Director

Committee Chairperson

+1 212 908 0239

MEDIA CONTACTS

Hannah James

New York

+1 646 582 4947

hannah.james@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\)](#)
[\(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 ([1](#))

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EU Endorsed

Johnson County Public Building Commission (KS)

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